88-682

Supreme Court, U.S.
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No. _____

IN THE SUPREME COURT

OF THE UNITED STATES

OCTOBER TERM, 1988

H & H BEVERAGE DISTRIBUTORS, INC.,
Petitioner,

v.

DEPARTMENT OF REVENUE OF THE
COMMONWEALTH OF PENNSYLVANIA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Does the automatic stay provision of the Bankruptcy Code bar the conduct of a post-petition sales tax audit of the Bankrupt by a State Department of Revenue outside the bankruptcy forum concerning the Bankrupt's pre-petition tax liabilities and the issuance of a final assessment thereon?

2. Does upholding the conduct of a sales tax audit ouside the bankruptcy forum and the issuance of an assessment thereon contravene the essential objectives of the Bankruptcy Code?

LIST OF PARTIES AND RULE 28.1 LIST

The parties to the proceedings below were the petitioner H & H Beverage Distributors, Inc. and the respondent Department of Revenue of the Commonwealth of Pennsylvania. The petitioner H & H Beverage Distributors, Inc. has no parent company, subsidiaries or affiliates to list pursuant to Rule 28.1.

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PETITION FOR A WRIT OF CERTIORARI
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The petitioner H & H Beverage Distributors, Inc. respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United State Court of Appeals for the Third Circuit, entered in the above-entitled proceeding on June 24, 1988, and upon which a rehearing was denied on July 19, 1988.

OPINIONS BELOW

The opinion of the Court of Appeals for the Third Circuit is not reported as yet, and is reprinted in the appendix hereto, p. 1a, infra. The order denying rehearing thereon is reprinted in the appendix hereto, p. 14a, infra.

The memorandum decision of the United States District Court for the Eastern District of Pennsylvania (Giles, D.J.) is reported at 79 B.R.205 (E.D. Pa. 1987). It is reprinted in the appendix hereto, p. 16a, infra.

JURISDICTION

The jurisdiction of this Court to review the judgment of the Third Circuit is invoked under 28 U.S.C. Section 1254 and Supreme Court Rule 17.

STATUTE INVOLVED

This case concerns application and interpretation of 11 U.S.C. Sections 362 (a) and 362 (b), which are set forth at length in the Appendix hereto, p. , infra.

STATEMENT OF THE CASE

The jurisdiction of the bankruptcy court was invoked under 28 U.S.C. Sections 157 and 1334 and 11 U.S.C. Sections 362 and 505. The jurisdiction of the district court was invoked under 28 U.S.C. Section 158 as an appeal from a final order of a bankruptcy court.

On January 20, 1984, Petitioner filed a voluntary petition under Chapter 11 of the Bankruptcy Code and was granted debtor in possession status. In August,

1984, the Pennsylvania Department of Revenue commenced a sales tax audit of Petitioner for the period January 1, 1981 - July 30, 1984. Upon completion of the audit on August 27, 1984, the state issued a final assessment against Petitioner for alleged tax deficiencies in the amount of $162,981.16 for this period. (See copy thereof at pp. 34a - 37a, infra.)

On January 16, 1986, Petitioner instituted an adversary proceeding against the Pennsylvania Department of Revenue. Petitioner sought, inter alia, to set aside the aforesaid sales tax assessment. The premise of these proceedings was that the conduct of the audit violated the automatic stay.

The bankruptcy court found that the state had willfully violated the automatic stay, declared the assessment and any lien therefrom void, and awarded

attorney fees and costs. Upon appeal, the district court affirmed the decision of the bankruptcy court.

In due course, the state filed an appeal to the Court of Appeals for the Third Circuit. The Court of Appeals held that the conduct of an audit and the assessment thereon did not violate the automatic stay and that the notice of audit assessment sent by the state fell within the exception set forth in Code Section 362(b)(9). The Court of Appeals accordingly reversed the judgment of the district court (except insofar as it voided any tax lien arising from the audit) with directions to remand the case to the bankruptcy court for further proceedings consistent with its opinion. (pp. 1a, infra.) The Petition for Rehearing was denied.

REASONS FOR GRANTING THE WRIT

I.

THE THIRD CIRCUIT'S DECISION FINDING NO VIOLATION OF THE AUTOMATIC STAY CONFLICTS, IN PRINCIPLE, WITH DECISIONS OF THIS COURT AND THE SIXTH CIRCUIT.

The Third Circuit ruled that the conduct of a post-petition sales tax audit of the Bankrupt by the Pennsylvania Department of Revenue concerning pre-petition tax liabilities and the issuance of the final assessment thereon, did not violate the automatic stay under Section 362 of the Bankruptcy Code. In principle, this decision empowers any state or municipal entity to pursue its normal administrative procedure, notwithstanding the filing of a bankruptcy

petition, to establish the amount of its claim against the bankrupt, provided said entity seeks to collect said claim only in the bankruptcy proceedings. This principle conflicts with three long-standing principles enunciated by the Court.

First, it has been firmly established by the Court that a state's power to assess and collect state taxes (and concomitantly its power to invoke its procedural method therefor) must submit to the Federal Rules and Regulations controlling the administration of the bankruptcy estate, Gardner v. New Jersey, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947); New York v. Irving Trust Company, 288 U.S. 329, 53 S.Ct. 389, 77 L.Ed. 815 (1933); Van Huffel v. Harkelrode, 284 U.S. 225, 52 S.Ct. 115, 76 L.Ed. 256 (1931).

Second, it is likewise established that the automatic stay under Code Section 362 ousts all forums except bankruptcy courts of jurisdiction to hear claims against the bankrupt immediately upon the filing for protection under the bankruptcy laws, Kalb v. Feuerstein, 308 U.S. 433, 60 S.Ct. 343, 84 L.Ed. 370 (1940).

Lastly, the Court has left no doubt that tax collecting agencies are fully subject to the Bankruptcy Code in their collection efforts, United States v. Whiting Pools, Inc., 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983). The Court noted that Congress had provided a definitive statutory scheme which enhances, where appropriate, collection of tax claims within the bankruptcy proceedings, United States v. Whiting Pools, Inc., supra, at p. 209.

It is submitted that the decision in In re Nashville White Trucks, Inc., 731 F.2d. 376 (6th Cir. 1984) reflects the proper application of the foregoing decisions of the Court. In that case, the Court of Appeals for the Sixth Circuit held that the Tennessee State Commissioner of Revenue could not assess or take any action to collect delinquent sales taxes against property of the debtor without obtaining relief in the Bankruptcy Court from the automatic stay.

The Third Circuit has established a precedent that can only cause confusion among the other Circuits. Plenary consideration of the matter by this Court is essential to prevent further reliance on this misapprehension of the law.

II.

THE DECISION BELOW WILL SERIOUSLY HINDER EFFICIENT ADMINISTRATION OF CASES UNDER THE BANKRUPTCY CODE.

This Court has never shirked its role as final arbiter for construction of federal statutes, particularly where such exercise is necessary to insure proper administration thereunder, New York v. Saper, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710 (1949); Rothensies v. Electric Battery Co., 329 U.S. 296, 67 S.Ct. 271, 91 L.Ed. 296 (1947); Shapiro v. United States, 335 U.S.1, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948).

The Bankruptcy Code, Section 362(a), provides (as relevant) that the following actions are automatically stayed upon the filing of a Petition:

(1) The commencement . . . of [an] administrative . . . action or proceeding against the debtor . . . to recover a claim against the debtor that arose before the commencement of the case under this title.[1]

(2) Any act to create . . . any lien against property of the estate;

(3) Any act to create . . . against property of the debtor any lien . . . that secures a claim that arose before the commencement of the case under this title; and

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1. The Code defines claim in very broad terms to include any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured, Section 101.04. The effect of this provision is that a claim arises before commencement of the case if the events upon which the liability is based occurred prior thereto.

(4) Any act to . . . assess a . . . claim against the debtor that arose before the commencement of the case under this title.

The foregoing sweeping interdiction of the automatic stay is, as relevant, only circumscribed by the exception set forth in Section 362(b)(9). This exception provides that a governmental entity may issue a post-petition notice of tax deficiency to a debtor. The Third Circuit concluded that the conduct of an audit outside of the bankruptcy proceedings (wherein the state determined an alleged tax deficiency of the Petitioner) and the issuance of a final assessment thereon, did not violate the automatic stay. Further, the Court of Appeals has concluded that the issuance of a notice of audit assessment thereon was within the exception of Section

362(b)(9). In effect, the Third Circuit construed Section 362(a) broadly and Section 362(b)(9) narrowly.

This construction of the Bankruptcy Code conflicts with decisions of the Court. The Court has long recognized the constitutional prerogative of Congress in the field of bankruptcy and reaffirmed the authority of Congress to define the relief available under the bankruptcy laws, Kalb v. Feuerstein, supra., pp. 438-439; United States v. Whiting Pools, Inc., supra.

It is clear that Congress intended the automatic stay to be one of the fundamental debtor protections afforded by bankruptcy law. See H.R. Report No. 95-595, 95th Cong., 1st Sess. 340 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6296-97.

This intent has been recognized by commentators, Collier on Bankruptcy, Para. 362.04, at pages indicated, (15th ed. 1988):

> "The stay of section 362 is extremely broad in scope and, aside from the limited exception of subsection (b), should apply to almost any type of formal or informal action against the debtor or property of the estate." (at page 362-31).
>
> "The 'precise' wording of the stay and its exceptions should be emphasized." (at page 362-33).

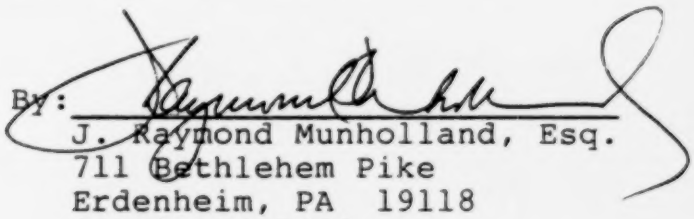
Petitioner urges the Court that the methodology of statutory construction applied in In re Stringer, 847 F.2d 549 (9th Cir. 1988) [construing Section 362(a)(1) broadly and Section 362(b)(2) narrowly] achieves congressional intent and is in accord with the decisions of the Court. The decision of the Third Circuit eviscerates the very core of bankruptcy relief and portends havoc for the efficient administration of bankruptcy cases.

It is thus incumbent upon the Court to assume jurisdiction and exercise its interpretive function in this critical area of bankruptcy law.

CONCLUSION

For the reasons stated herein, a Writ of Certiorari should issue to review the judgment and opinion of the Court of Appeals for the Third Circuit in this matter.

Respectfully submitted,



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October 14, 1988

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 87-1695

IN RE: H & H BEVERAGE DISTRIBUTORS

v.

DEPARTMENT OF REVENUE OF THE
COMMONWEALTH OF PENNSYLVANIA

COMMONWEALTH OF PENNSYLVANIA,
PENNSYLVANIA DEPARTMENT OF REVENUE,

Appellant

On Appeal from the United States District
Court for the Eastern District
of Pennsylvania
(D.C. Civil Action No. 86-3772)

Argued April 15, 1988

Before: HUTCHINSON, SCIRICA and ROSENN,
Circuit Judges

(Filed June 24, 1988)

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OPINION OF THE COURT

SCIRICA, *Circuit Judge*.

In this appeal we must determine whether the Commonwealth of Pennsylvania violated the automatic stay in a Chapter 11 bankruptcy proceeding, 11 U.S.C. § 362 (1982), by conducting a sales tax audit and issuing a notice of audit assessment to the debtor, H & H Beverage Distributors, Inc. ("H & H"). The district court affirmed the bankruptcy court and concluded that both the audit and the notice violated the automatic stay's prohibition against "any act to create, perfect, or enforce" a lien, *see* §§ 362(a)(4), (a)(5), because the acts constituted "the statutory prerequisites to the creation of a lien under the Pennsylvania Tax Code ...." *H & H Beverage Distrib., Inc. v. Department of Revenue of Pennsylvania*, 79 Bankr. 205, 207 (E.D. Pa. 1987).

Our review is plenary, *In re Remington Rand Corp.*, 836 F.2d 825, 828 (3d Cir. 1988), and for reasons that follow, we will reverse. We hold that the Commonwealth was entitled to audit H & H to ascertain the extent of any claim it may have. Moreover, although issuance of a notice of audit assessment was a step toward the creation of a lien, it was expressly permitted under § 362(b)(9), which provides that issuance by a governmental unit of a notice of tax deficiency is not subject to the automatic stay.

I.

H & H filed a voluntary petition on January 20, 1984, under Chapter 11 of the Bankruptcy Reform Act of 1978 ("the Code"), 11 U.S.C. § 1101, and was granted debtor-in-possession status. The Commonwealth received notice of the Chapter 11 filing and in August, 1984, undertook a sales tax audit for the period from January 1, 1981 to July 30, 1984. Upon completing the audit on August 27, 1984, the Commonwealth sent H & H a "notice of audit assessment," which read:

> Final Assessment
>
> A certificate of lien will be filed with the prothonotary of your county, unless this assessment is paid or a notice of intent to appeal is filed with the board of appeals within thirty (30) days of the assessment mailing date ....

J.A. at 5. The notice stated that H & H owed $162,981.16 in unpaid sales tax.

H & H initiated the administrative appeal process in an effort to obtain a redetermination of the audit findings. Its state appeal is pending in the Pennsylvania Commonwealth Court. In addition, H & H filed a complaint on January 16, 1986 in the United States Bankruptcy Court, seeking to set aside the sales tax assessment, or in the alternative to have the bankruptcy court determine H & H's tax liability.

The bankruptcy court ruled that the audit and the assessment of tax liability against H & H violated the automatic stay under § 362(a). Moreover, the court concluded, because the violations were made with knowledge of the bankruptcy petition, H & H was entitled to attorneys' fees and costs. Accordingly, the bankruptcy court declared the assessment null and void and held that any lien arising from the assessment must be stricken. The district court affirmed,

reasoning that the audit, assessment, and notice were prerequisites to the creation of a lien, and under Pennsylvania law, a "lien would be automatically created absent action by the debtor." Therefore, the district court held, the Commonwealth willfully violated the automatic stay.

II.

An automatic stay under § 362 of the Code "is one of the fundamental debtor protections provided by the bankruptcy laws." H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787. Its essential purpose is twofold: (1) to protect creditors and thereby promote the bankruptcy goal of equal treatment, *Hunt v. Bankers Trust Co.*, 799 F.2d 1060, 1069 (5th Cir. 1986); and (2) to give the debtor a breathing spell. H.R. Rep. No. 595, at 340.

> [The automatic stay] stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

Id.; S. Rep. No. 989, 95th Cong., 2d Sess. 50 (1978); *see generally* 2 *Collier on Bankruptcy* § 362.04, at 362-31 (L. King ed. 1988).

In order to examine the issue of tax liability when a stay has been issued, we turn to § 362(a), which prohibits:

> (4) any act to create, perfect, or enforce any lien against property of the estate;
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; ....

Id.; *see also* S. Rep. No. 989, at 50 (1978) ("To permit lien creation after bankruptcy would give certain creditors preferential treatment ...."). Despite § 362(a)'s broad prohibitions, the Code provides that a Chapter 11 filing "does not operate as a stay ... of the issuance to the debtor by a governmental unit of a notice of tax deficiency." *Id.* § 362(b)(9). Moreover, pursuant to § 505 of the Code, the bankruptcy court is empowered under certain circumstances -- notwithstanding § 362 -- to determine the amount or legality of a tax "whether or not previously assessed, whether or not paid, and whether or not contested ...." *Id.* § 505(a)(1), (c). When the bankruptcy court makes this determination, the governmental unit charged with collecting the tax may then assess the tax against the debtor. Thus, once a bankruptcy proceeding is instituted, and a § 362(b)(9) notice of tax deficiency has been issued for prepetition taxes, the bankruptcy court has the option of referring the tax issue to the Tax Court or making its own determination.

The parties' positions in this matter are straightforward. H & H contends that the Commonwealth willfully violated the automatic stay's prohibition of any act to create a lien. The Commonwealth maintains that it must conduct an audit before filing a proof of claim, and before it can notify a debtor of any deficiency. It also contends that its notice of audit assessment is expressly permitted under § 362(b)(9).

The bankruptcy court determined that the act of auditing was a per se violation of the automatic stay; the district court affirmed on different grounds, concluding that the audit violated the stay because it was followed by a tax assessment and the issuance of a

tax assessment notice to the taxpayer. Under either theory, the district court's judgment must be reversed.

III.

Auditing a debtor's sales tax records does not by itself constitute an act to create a lien or collect a claim. The Commonwealth, like any other creditor, is entitled to determine whether it possesses a valid claim against the debtor. *Cf. In re Remington Rand*, 836 F.2d at 827, 832 (government audit of Chapter 11 debtor's records to determine whether it had a right to payment for breach of contract). In many cases, prohibiting a tax audit would prevent the Commonwealth from filing a proof of claim. *See* 124 Cong. Rec. H11110 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards explaining House amendments to Code) ("Where no proceeding in the Tax Court is pending at the commencement of the bankruptcy case, the tax authority can ... file a claim against the estate for a prepetition tax liability ...."); *accord* Bankr. R. 3001.[1] In addition, it would prevent governmental units from determining whether a tax deficiency exists, and thereby render meaningless § 362(b)(9), which expressly permits taxing entities to issue notices of tax deficiency.

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1. The Commonwealth does not contend that it should be exempt from proof of claim filing requirements that generally apply in bankruptcy proceedings. Indeed, governmental entities that fail to file a proof of claim usually do so at their peril. *See In re Chicago, Milwaukee, St. Paul & Pacific R.R. Co.*, 830 F.2d 758, 765 & n.8 (7th Cir. 1987) (government's claim for tax penalty disallowed because it failed to file proof of claim); *In re Connecticut Motor Lines, Inc.*, 336 F.2d 96, 107 (3d Cir. 1964) (government must file proof of claim for unpaid taxes); *see also In re Ribs-R-Us, Inc.*, 828 F.2d 199, 199 (3d Cir. 1987) (government filed proof of claim for back taxes after debtor filed for Chapter 11 reorganization).

IV.

H & H contends that even if the automatic stay does not bar the audit, the district court correctly concluded that issuance of the notice of audit assessment was void because it would automatically result in imposition of a lien in favor of the Commonwealth.

As we have noted, § 362(b)(9) of the Code provides that the automatic stay does not bar a governmental entity from issuing a "notice of tax deficiency." Thus, although a governmental unit may not collect taxes or create a lien during the stay, it may notify a debtor of a tax deficiency. This provision, which applies to governmental units, was based on the workings and terminology of the federal taxing scheme. *See In re Hardy*, 39 Bankr. 64, 66 (Bankr. E.D. Pa. 1984) (Internal Revenue Service ("IRS") notice of tax deficiency does not violate the automatic stay).

Congress exempted the notice of tax deficiency from the automatic stay to "permit the debtor to take his personal tax case to the Tax Court, if the bankruptcy judge authorizes him to do so (as explained more fully in the discussion of section 505.)" 124 Cong. Rec. H11110 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards); *see also In re Community Hosp. of Rockland County*, 15 Bankr. 785, 790 (Bankr. S.D.N.Y. 1981); 1 W. Norton, *Norton Bankruptcy Law and Practice* § 20.21 & n.2 (1981) (notice of tax deficiency is "condition precedent" to debtor's application to proceed in Tax Court should automatic stay be set aside); *cf.* H.R. Rep. No. 96-833, 96th Cong., 2d Sess. 43 & nn. 3,4 (1980) (bill amending Internal Revenue Code to provide for tax treatment in bankruptcy -- if a deficiency notice has been issued, bankruptcy court may lift automatic stay in case involving corporate debtor and permit tax issue to be

determined in Tax Court). Thus, once a deficiency notice has been issued, a debtor's tax liability can be resolved in one of two ways:

> In essence ... the bankruptcy judge will have authority to determine which court will determine the merits of the tax claim both as to claims against the estate and claims against the debtor concerning his personal liability for nondischargeable taxes. Thus, if the Internal Revenue Service, or a State or local tax authority files a petition to determine dischargeability, the bankruptcy judge can either rule on the merits of the claim and continue the stay on any pending Tax Court proceeding or lift the stay on the Tax Court and hold the dischargeability complaint in abeyance.

124 Cong. Rec. at 11111 (remarks of Rep. Edwards).[2]

Because the § 362(b)(9) exemption cited by the Commonwealth has its origins in the federal tax system, we must compare the federal taxing procedure with analogous provisions in Pennsylvania law. Although § 362(b)(9) uses the term "notice of tax deficiency," the provision applies to any governmental unit. Based on the statutory language and legislative history, we conclude that the Code contemplated that

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2. Based on this reasoning, we question whether H & H may pursue its state administrative tax remedies during the pendency of the automatic stay without permission of the bankruptcy court. By filing its administrative appeal, H & H apparently attempted to comply with the time limitations imposed under Pennsylvania tax law. Under federal law, of course, the time prescribed for filing a petition for review in the Tax Court is suspended during the period in which an automatic stay bars the debtor from filing a tax appeal. *See* 26 U.S.C. § 6213(f)(1).

On remand, the bankruptcy court must decide whether to lift the stay to allow completion of H & H's state appeal.

all governmental taxing entities should receive equal treatment under § 362. Therefore, because the Commonwealth does not label its notice a "tax deficiency" notice, we must examine the effect of a federal, *i.e.*, an IRS, "notice of tax deficiency," and then compare Pennsylvania's equivalent notice provision.

The effect of an IRS notice is based on the agency's statutory authority to "make inquiries, determinations, and assessments" of all unpaid taxes, 26 U.S.C. § 6201. If the IRS finds a tax deficiency, it must issue a formal "notice of tax deficiency." *Id.* § 6212. Within ninety days of receiving the IRS notice, the taxpayer may file a petition with the Tax Court for redetermination. *Id.* § 6213(a).[3] If the taxpayer does not appeal for a redetermination "the deficiency shall be assessed, and shall be paid upon notice and demand from the Secretary." *Id.* § 6213(c). An assessment involves formally recording the taxpayer's liability in the office of the Secretary. *Id.* § 6203. If the tax is assessed and not paid on demand "the amount ... shall be a lien in favor the United States." *Id.* § 6321.

Thus, the IRS cannot obtain a lien until it has issued a notice of tax deficiency. *Wallin v. Commissioner of Internal Revenue*, 744 F.2d 674, 676 (9th Cir. 1984); *United States v. Zolla*, 724 F.2d 808,

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3. Under the pre-Code procedure, the government could -- under certain circumstances -- immediately assess a Chapter 11 debtor's tax liability without regard to the notice requirements of 26 U.S.C. § 6213(a). *See id.* § 6871. Thus, a debtor would never receive a notice of tax deficiency and therefore, would never be able to resort to the Tax Court.

Although the Code did not expressly repeal § 6871, the drafters of the Code believed that § 6871 was "effectively repealed" by the automatic stay provisions. *See* 2 W. Norton, *Norton Bankruptcy Law & Practice* § 44.05 & n.6 (1981). Otherwise, the Code's allowance of a notice of tax deficiency would be a meaningless gesture.

810 (9th Cir.), *cert. denied*, 469 U.S. 830 (1984). It can calculate the amount of unpaid taxes, and it can notify the taxpayer of the total deficiency, but it cannot formally assess tax liability and create a lien. "By filing a petition for reorganization, a debtor obtains a stay of pending and future litigation, including assessment of federal tax liabilities." *In re Ribs-R-Us, Inc.*, 828 F.2d 199, 203 (3d Cir. 1987).

Pennsylvania follows a similar procedure for collecting delinquent taxes. Like the IRS, the Commonwealth is authorized "to make inquiries, determinations and assessments" of taxes due. 72 Pa. Cons. Stat. Ann. § 7230 (Purdon Supp. 1988). When a taxpayer has not filed a return, understated his tax, or underpayed his tax, "[a] notice of assessment in the estimated amount shall be sent to the taxpayer." *Id.* § 7231(c). Within thirty days of receiving notice, the taxpayer is required to either pay the deficiency or begin the appellate process by petitioning the Commonwealth for reassessment. *Id.* §§ 7231, 7232. If the taxpayer is deemed liable for the tax deficiency and "neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the Commonwealth ... only after same has been entered and docketed of record by the prothonotary ...." *Id.* § 7242(a).[4]

Although Pennsylvania labels its provision a "notice of audit assessment," the effect and purpose of the notice is identical to an IRS "notice of tax deficiency."[5] In both cases, the notice is statutorily

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4. In the context of a sales tax, Pennsylvania does not require issuance of a judicial writ of scire facias before creation of a lien. *Id.* § 7242(b).

5. One of the problems in this case stems from Pennsylvania's use of the word "assessment" in its notice form. Under federal law, an assessment is a formal act of officially recording liability in the office of the Secretary. *See* discussion *supra*. A federal tax assessment officially records the "fact and amount of liability ...

required and commences the process by which the taxpayer either pays the government's estimate of the tax due or appeals for redetermination. Indeed, the notice in this case specifically alerted H & H that "[a] certificate of lien will be filed with the prothonotary of your county unless this assessment is paid or a notice of intent to appeal is filed ... within thirty (30) days ...." J.A. at 5. More importantly, issuance of the notice was not tantamount to the creation of a lien. First, H & H was in the midst of its administrative appeal in the state court system, and the Commonwealth cannot obtain a lien until the appeal is resolved. Second, no lien is created under Pennsylvania law until the Commonwealth demands the amount, interest, penalty and cost, and the taxpayer neglects or refuses to pay.

Thus, the Commonwealth could not create a lien until it made a formal demand for the full amount due upon completion of the appeal and then filed the amount of that liability with the prothonotary. Pursuant to § 362(a), these are the acts that would violate the bankruptcy stay. Therefore, the Commonwealth's notice of audit assessment is the functional equivalent of the notice of tax deficiency,

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with consequences somewhat similar to the reduction of a claim to judgment." *Cohen v. Gross*, 316 F.2d 521, 522-23 (3d Cir. 1963); *accord United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985). It occurs after issuance of a notice of deficiency, in which the taxpayer has been given the option to appeal or pay the tax. *Cohen*, 316 F.2d at 522.

Under Pennsylvania law, however, the term is used to designate the Commonwealth's calculation of tax deficiency. It is made before a taxpayer receives any form of notice and is therefore not an official act that results in tax liability; *i.e.*, it is not a formal step that must be taken after the taxpayer has been notified of a deficiency and has either: (1) neglected to pay the tax; or (2) declined to file an administrative appeal.

and pursuant to § 362(b)(9), it is expressly permitted during the pendency of an automatic stay. No lien could be created until the Commonwealth filed the amount of liability with the prothonotary. Accordingly, we hold that the Commonwealth does not violate the automatic stay by auditing a debtor, *i.e.*, calculating its claim, and then issuing a notice of audit assessment. Because the state and federal notices have the same effect, there is no reason to permit the federal notice pursuant to § 362(b)(9), yet bar the equivalent state notice.

Once the notice is issued, however, the Commonwealth is barred from taking steps to create a lien.[6] The method of calculating and determining tax liability -- at least at that point -- is a task reserved for the bankruptcy court. *See* § 505. Indeed, the Commonwealth's audit provides the bankruptcy court with a starting point for determining final tax liability and upon issuance of a deficiency notice (or notice of audit assessment) under § 362(b)(9), the Code gives the court the option of allowing the debtor to pursue an administrative appeal.

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6. H & H contends that the Commonwealth further violated the bankruptcy court's order by filing a lien certificate with the prothonotary of the Court of Common Pleas of Philadelphia County on January 16, 1987 (after the bankruptcy court's judgment was entered) for $188,597.55. The Commonwealth maintains that the lien was filed when H & H failed to post a security bond when it petitioned for appellate review. *See* Pa. R. App. P. 1782 (bond for 120 percent of tax and penalty due must be filed with prothonotary of the Commonwealth Court by party seeking review of an order of the Board of Finance and Revenue in a tax matter). The fact that the Commonwealth filed its lien with the prothonotary of the Court of Common Pleas, rather than with the prothonotary of the Commonwealth Court, as required by Pa. R. App. P. 1782, lends support to H & H's position that the January 16, 1987 lien was a tax lien. *See* 72 Pa. Cons. Stat. Ann. § 7242(a) (tax lien must be filed with county prothonotary).

Accordingly, we will reverse the judgment of the district court, except insofar as it voids the tax lien created by the Commonwealth with the prothonotary of the Court of Common Pleas, with directions to remand the case to the bankruptcy court for further proceedings consistent with this opinion.[7]

Whatever the merits of the Commonwealth's assertion that H & H failed to file an appeal bond, the issue was not raised before the bankruptcy court or the district court, and we are not presented with that issue on appeal. Moreover, the creation of any lien, regardless of the its purpose, is barred by § 362. Thus, to the extent the Commonwealth has created a lien in this case, it is void.

7. Because we hold that the Commonwealth did not violate the automatic stay, we will also reverse the district court's award of costs and attorneys' fees for the Commonwealth's alleged willful violation of the stay.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 87-1695

IN RE: H & H BEVERAGE DISTRIBUTORS

v.

DEPARTMENT OF REVENUE OF THE
COMMONWEALTH OF PENNSYLVANIA

COMMONWEALTH OF
PENNSYLVANIA,
PENNSYLVANIA
DEPARTMENT OF
REVENUE

Appellant

(D.C. Civ. No. 86-3772)

SUR PETITION FOR REHEARING

Present: GIBBONS, Chief Judge,
SEITZ, HIGGINBOTHAM, SLOVITER, BECKER,
STAPLETON, MANSMANN, GREENBERG,
HUTCHINSON, SCIRICA and COWEN,
Circuit Judges.

The petition for rehearing filed by appellee in the above-entitled case having been submitted to the judges who

participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the Court in banc, is denied.

BY THE COURT

/s/Anthony J. Scirica
Circuit Judge

Dated: July 19, 1988

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

H & H BEVERAGE DISTRIBUTORS, INC., et al.	:	CIVIL ACTION
v.	:	
DEPARTMENT OF REVENUE OF THE COMMONWEALTH OF PENNSYLVANIA	:	NO. 86-3772

MEMORANDUM

GILES, J. OCTOBER 8, 1987

Appellee, H & H Beverage Distributors, Inc. filed a voluntary petition under Chapter 11 of the Bankruptcy Code on January 20, 1984, and was granted debtor-in-possession status. In August of 1984, Appellant, Department of Revenue of the Commonwealth of Pennsylvania, conducted a sales tax audit of Appellee for the years 1981-1984. Appellant then sent Appellee a "Notice of Audit Assessment." (Record of Appeal, Exhibit

A). The notice stated that Appellee owed $162,981.16 and was labelled a "Final Assessment." The notice further stated that a lien certificate would be filed with the Prothonotary of Philadelphia County unless the taxes were paid within thirty days or a Notice of Intent to Appeal was filed within such time. Appellee filed such a Notice of Intent to Appeal.

On January 16, 1986, Appellee filed a Complaint with the bankruptcy court against Appellant. The Complaint sought to set aside the tax assessment and to strike any lien arising from the assessment or, in the alternative, to have the bankruptcy court determine the amount of tax due. Appellee also requested that the court award attorney fees and costs.

The bankruptcy court held on May 21, 1986, that the sales tax audit was in

violation of the automatic stay of 11 U.S.C. section 362(a) and that the assessment of additional sales taxes, penalties and interest against the Appellant in the amount of $162,981.16 as a result of the audit was in violation of the automatic stay. Finally, it held that these violations of the stay were made with knowledge of the filing of the bankruptcy petition, thereby entitling the debtor to attorney fees and costs. (Order of May 21, 1986).

DISCUSSION

I. Appellant Violated the Automatic Stay Provision of the Bankruptcy Code

A. The Audit

Appellee contends that the sales tax audit violated the automatic stay

provision of the Bankruptcy Code.[1] Appellant counters that the audit was allowed under 11 U.S.C. section 1106(a)(6). This section provides that a trustee shall:

> for any year for which the debtor has not filed a tax return required by law, furnish, without personal liability, such information as may be required by the governmental unit. . . .

---

1. Section 362. Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title operates as a stay, applicable to all entities, of --

* * *

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title.

* * *

Appellant argues that an audit by the governmental unit also falls within this Subsection.

Appellant's audit of Appellee cannot, however, be viewed alone. The audit was conducted, a final assessment made, and a Notice of Audit Assessment sent to Appellee. (Record, Exhibit A). These actions were the statutory prerequisites to the creation of a lien under the Pennsylvania Tax Code, 72 P.S. Section 7231(c). As such, they violated Section 362(a)(4) and Section 362(a)(5) which forbid any acts toward the creation of a lien against property of the debtor. See footnote 1, supra.

B. The Notice of Audit Assessment

Appellant argues that the Notice of Audit Assessment did not violate the automatic stay because it falls under the exception of 11 U.S.C. Section 362(b)(9). Subsection (b)(9) provides that the

filing of a bankruptcy petition does not stay "the issuance to the debtor by a governmental unit of a notice of tax deficiency." In a recent case, the court held that a similar "notice of assessment /determination" sent to a debtor fell under the exception of Subsection (b)(9). In re Fasgo, No. 86-1995, slip op. (E.D. Pa. Sept. 30, 1986). There, however, Judge Newcomer found that the notice of assessment did not "in and of itself result in the liability being collected from or levied upon the debtor or the enforcement of a lien upon the debtor's property." The court noted that there was no statute to convert the tax deficiency into a lien and that the Commonwealth had to obtain a writ of scire facias in state court before any action could be taken. In re Fasgo, No. 86-1995, slip op. (E.D. Pa. Sept. 30, 1986).

In the present case, the Notice of Audit Assessment clearly stated that a certificate of lien would be filed with the prothonotary of the debtor's county unless the debtor paid the debt or sought review. The lien would be automatically created absent action by the debtor. (Record of Appeal, Exhibit A). The purpose of the automatic stay provision is to give "the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment and all foreclosure actions." Notes of Committee on the Judiciary, Senate Report No. 95-989. Notice requirement that Appellee pay the debt or seek immediate review in order to avoid a lien interfered with this basic purpose. It far surpassed the limits of a notice of tax deficiency and constituted an act towards the creation of a lien. As such, it violated the automatic stay provision

of Section 362(a)(4) and (a)(5).

C. Appellee is Entitled to Costs and Attorney Fees

Appellant, citing In re Hammett, 29 B.R. 1012 (E.D. Pa. 1983), argues that attorney fees cannot be awarded in the absence of bad faith or misconduct. Contrary to Appellant's argument, that case is inapposite. The court in In re Hammett held that an award of attorney fees must be based on bad faith or gross misconduct where there was no provision in the Bankruptcy Act which expressly authorized an award of attorney fees. Id., at 1015. Here, there is a specific statutory provision for attorney fees where an automatic stay is violated. It requires only a "willful violation of a stay." 11 U.S.C. section 362(h).

Violation of an automatic stay with the knowledge that a bankruptcy petition has been filed constitutes a "willful"

act. The court may assess fines and award counsel fees to compensate the debtor for bringing the action to enforce his or her rights under the Bankruptcy Act. In re Demp, 23 B.R. 239 (E.D. Pa. 1982); Fidelity Mortgage Investors v. Camelia Builders, Inc., 550 F.2d 47 (2nd Cir. 1976). The bankruptcy court found that Appellant had knowledge of Appellee's bankruptcy petition. (Order of May 21, 1986). This court has no basis for overturning that court's finding without evidence that its conclusion was clearly erroneous. No such evidence exists. Therefore, the bankruptcy court's Order of May 21, 1986, is AFFIRMED.

Section 362. Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of--

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate,

of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the

commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay--

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;

(3) under subsection (a) of this section, of any act to perfect an

interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(6) under subsection (a)(7) of this section, of the setoff by a commodity

broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from, such commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency to

margin, guarantee, secure, or settle commodity contract, forward contracts, or securities contracts;

(7) under subsection (a) of this section, of the setoff by a repo participant, of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of repurchase agreements against cash, securities, or other property held by or due from such repo participant to margin, guarantee, secure or settle repurchase agreements;

(8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the

mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;

(9) under subsection (a) of this section, of the issuance to the debtor by a governmental unit of a notice of tax deficiency;

(10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property; or [sic]

(11) under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protestent dishonor of such

an instrument.

(12) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Transportation under Ship Mortgage Act, 1920 (46 App. U.S.C. 911 et seq.) (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage, or a security interest in or relating to a vessel or vessel under construction, held by the Secretary of Transportation under section 207 or title XI of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271 et seq., respectively), or under applicable State law; or

(13) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Commerce under the Ship Mortgage Act, 1920 (46 App. U.S.C. 911 et seq.) (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage in a vessel or a mortgage, deed of trust, or other security interest in a fishing facility held by the Secretary of Commerce under section 207 or title XI of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271 et seq. respectively).

REV-943 AU * (5-84)

NOTICE OF AUDIT ASSESSMENT

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Department of Revenue
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FINAL ASSESSMENT

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CHECKS SHOULD BE MADE PAYABLE TO THE PENNSYLVANIA DEPARTMENT OF REVENUE AND FORWARDED IN THE ENCLOSED ENVELOPE.

SEE REVERSE SIDE FOR EXPLANATION OF INTEREST, ADDITIONS, PENALTIES, OTHER CHARGES, AND INSTRUCTIONS FOR FILING PETITION TO THE BOARD OF APPEALS.

This assessment is made in accordance with the provisions of "The Tax Reform Code of 1971" as amended.

H & H BEVERAGE DIST INC

4252 RISING SUN AVE
PHILADELPHIA PA 19140

Account No.	Assessment No.	Assessment Mailing Date	Audit Completion Date	Period Assessed		CASE NUMBERS COVERED BY THIS AUDIT
51-206534	A -04935	12/16/84	08/27/84	01/01/81	07/30/84	04935 04936

YEAR	PERIOD	Code	Due Date	Tax Established By Audit	Less Tax Reported or Previously Assessed	Credit	Tax Deficiency Due	Underassessment Penalty	Failure to File, Late File Major Underassessment	Other Charges	Interest Due	Total
81	JAN	S	03/15/81	5427.10	2466.43		2960.67	148.03	740.17		999.23	4,848.10
81	FEB	S	04/15/81	4948.70	2833.38		2115.32	105.77			698.06	2,919.15
81	MAR	S	05/15/81	5355.83	3391.29		1964.54	98.23			633.56	2,696.33
81	APR	S	05/20/81	6720.10	4069.94		2650.16	132.51			854.68	3,637.35
81	MAY	S	06/20/81	7453.10	5191.18		2301.92	115.10			725.10	3,142.12
81	JUN	S	08/15/81	8678.72	4319.77		4358.95	217.95	1089.74		1307.69	6,974.33
81	JUL	S	09/15/81	9870.39	7086.57		2783.82	139.19			814.27	3,737.28
81	AUG	S	10/15/81	9900.87	5704.47		4196.40	209.82			1195.97	5,602.19
81	SEP	S	11/15/81	9557.19	4865.20		4691.99	234.60			1302.03	6,228.62
81	OCT	S	12/15/81	7679.33	5261.97		2417.36	120.87			652.69	3,190.92
81	NOV	S	01/15/82	7760.49	4662.59		3097.50	154.88			1392.31	4,644.69
81	DEC	S	02/15/82	9585.18	7081.45		2507.73	125.39			1084.61	3,717.73
82	JAN	S	03/15/82	6575.84	3531.79		3044.05	152.20			1269.87	4,466.12
82	FEB	S	04/15/82	6241.79	3718.95		2522.84	126.14			1009.58	3,658.56
82	MAR	S	05/15/82	6377.38	3015.03		3362.27	168.11	840.57		1290.22	5,661.17
82	APR	S	05/20/82	7132.69	2239.37		4893.32	244.67	1223.33		1864.33	8,225.65
82	MAY	S	06/20/82	8391.65	5251.48		3140.17	157.01			1143.04	4,440.22
82	JUN	S	08/15/82	8242.34	4581.30		3661.04	183.05			1220.29	5,064.38

(A-34)

REV 84) AU-1 (5-84)

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H & H BEVERAGE DIST INC

4252 RISING SUN AVE
PHILADELPHIA PA 19140

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Account No.	Assessment No.	Assessment Mailing Date	Audit Completion Date	Period Assessed	
51-204534	A -04935	12/10/84	08/27/84	01/01/81	07/30/84

CASE NUMBERS COVERED BY THIS AUDIT
04935 04936

Year	Period	Code	Due Date	Tax Established By Audit	Less Tax Reported or Previously Assessed	Credit	Tax Deficiency Due	Understatement Penalty	Failure to File, Late File, Major Understatement	Other Charges	Interest Due	Total
82	JUL	S	09/15/82	9430.03	5864.79		3565.24	178.26			1127.80	4,871.30
82	AUG	S	10/15/82	7519.86	3870.45		3649.41	182.47			1094.43	4,926.31
82	SEP	S	11/15/82	8251.87	4916.42		3335.45	166.77			943.61	4,445.83
82	OCT	S	12/15/82	7020.63	4861.24		2259.39	112.97			602.04	2,974.40
82	NOV	S	01/15/83	7274.07	4007.39		3267.68	163.38			820.60	4,251.66
82	DEC	S	02/15/83	8909.84	4559.31		4350.53	217.53			1033.46	5,601.52
83	JAN	S	03/15/83	5695.86	2726.08		2969.78	148.49	742.45		669.04	4,529.76
83	FEB	S	04/15/83	5340.66	3109.13		2231.53	111.58			472.43	2,815.54
83	MAR	S	05/15/83	6924.74	4256.96		2667.78	133.39			529.73	3,330.90
83	APR	S	05/20/83	7139.14	3599.47		3539.67	176.98			695.10	4,411.75
83	MAY	S	06/20/83	3340.95	NOT FILED		3340.95	167.05	835.24		640.88	4,984.12
83	JUN	S	08/15/83	7570.25	5760.96		1809.29	90.46			286.35	2,186.10
83	JUL	S	09/15/83	7684.25	3267.95		4416.30	220.82	1104.08		639.00	6,380.20
83	AUG	S	09/20/83	6963.10	5211.94		1751.16	87.56			249.54	2,088.26
83	SEP	S	10/20/83	5857.73	3087.60		2770.13	138.51			358.35	3,266.99
83	OCT	S	11/20/83	4914.73	2798.08		2116.65	105.83			245.07	2,467.55
83	NOV	S	12/20/83	4204.04	NOT FILED		4204.04	210.20	1051.01		469.48	5,934.73
83	DEC	S	01/20/84	5005.26	3315.27		1689.99	84.50			155.15	1,929.64

(A-35)

REV 841 AU 1 (9-84)

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H C H BEVERAGE DIST INC

4252 RISING SUN AVE
PHILADELPHIA PA 19140

This assessment is made in accordance with the provisions of "The Tax Reform Code of 1971" as amended.

Account No.	Assessment No.	Assessment Mailing Date	Audit Completion Date	Period Assessed		CASE NUMBERS COVERED BY THIS AUDIT
51-204534	A -04935	12/10/84	08/27/84	01/01/81	07/30/84	04935 04936

YEAR	PERIOD	TAX	Due Date	Tax Established By Audit	Less Tax Reported or Previously Assessed	Credit	Tax Deficiency Due	Understatement Penalty	Failure to File, Late File, Major Understatement	Other Charges	Interest Due	Total
84	JAN	S	02/20/84	2727.91	1012.78		1715.13	85.76	428.78		141.45	2,371.12
84	FEB	S	03/20/84	3115.77	2175.13		944.64	47.23			69.66	1,061.53
84	MAR	S	04/20/84	2983.81	2343.81		640.00	32.00			41.22	713.22
84	APR	S	05/20/84	3423.04	2472.72		950.32	47.52			52.63	1,050.47
84	MAY	S	06/20/84	3545.57	2705.67		1239.90	62.00			57.10	1,359.00
84	JUN	S	07/20/84	4338.55	3805.70		532.85	26.64			19.73	579.22
84	JUL	S	08/20/84	5020.83	3540.70		1480.13	74.01			40.99	1,595.13
					SALES TAX		118107.99	5905.43	8055.37		30912.37	162,981.16
					USE TAX							.00
					TOTALS		118107.99	5905.43	8055.37		30912.37	162,981.16
				BALANCE			118107.99	5905.43	8055.37		30912.37	162,981.16

(A-36)

REV-841 AU • (5-84)

NOTICE OF AUDIT ASSESSMENT

Commonwealth of Pennsylvania
Department of Revenue
Bureau of Audits
P.O. Box 8930
Harrisburg, Pennsylvania 17105
Telephone (717) 787-6631

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4252 RISING SUN AVE
PHILADELPHIA PA 19140

This assessment is made in accordance with the provisions of "The Tax Reform Code of 1971" as amended.

Account No.	Assessment No.	Assessment Mailing Date	Audit Completion Date	Period Assessed		CASE NUMBERS COVERED BY THIS AUDIT
51-204534	A -04935	12/10/84	08/27/84	01/01/81	07/30/84	04935 04936

YEAR	PERIOD	SUFFIX	Due Date	Tax Established By Audit	Less Tax Reported or Previously Assessed	Credit	Tax Deficiency Due	Understatement Penalty	Failure to File, Late File, Major Understatement	Other Charges	Interest Due	Total

INTEREST IS IMPOSED UPON THE AMOUNT OF TAX DUE AT THE FOLLOWING RATES FROM THE DUE DATE OF THE RETURN TO THE DATE THE TAX DUE HAS BEEN PAID.

A. FOR DUE DATES FROM JUNE 16, 1974 THRU DECEMBER 31, 1981, NINE PERCENT PER ANNUM -- .0075 FOR EACH MONTH OR FRACTION THEREOF.

B. FOR DUE DATES FOLLOWING JANUARY 1, 1982 -

1. 20 PER CENT (.000548 DAILY) FROM JANUARY 1, 1982, THROUGH DECEMBER 31, 1982.

2. 16 PER CENT (.000438 DAILY) FROM JANUARY 1, 1983, THROUGH DECEMBER 31, 1983.

3. 11 PER CENT (.000301 DAILY) FROM JANUARY 1, 1984, THROUGH DECEMBER 31, 1984.

4. 13 PER CENT (.000356 DAILY) FROM JANUARY 1, 1985, THROUGH DECEMBER 31, 1985.

(A-37)

88-682

Supreme Court, U.S.
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NO. 87-1695
IN THE SUPREME COURT OF THE
UNITED STATES

OCTOBER TERM, 1988

H & H BEVERAGE
DISTRIBUTORS, INC.
Petitioner

v.

DEPARTMENT OF REVENUE OF THE
COMMONWEALTH OF PENNSYLVANIA
Respondent

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Is a state taxing authority entitled to audit the tax records of a debtor in bankruptcy to ascertain the extent of any tax claims it may have?

2. When a state taxing authority's issuance of a "Notice of Audit Assessment" is the functional equivalent of an issuance of a "Notice of Tax Deficiency" as that term is used in the Bankruptcy Code, is the state's notice also excepted from the automatic stay provisions of the Code by U.S.C. 362(b)(9)?

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STATEMENT OF THE CASE

On January 20, 1984, H & H Beverage Distributors, Inc., a Pennsylvania corporation, filed a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et. seq., and was granted debtor-in-possession status. In August, 1984, the Commonwealth of Pennsylvania's Department of Revenue performed a tax audit on H & H Beverage's records due to the corporation's failure to file pre-petition sales tax returns and its failure to remit post-petition sales tax payments. Upon completion of the audit on August 27, 1984, the Department sent to the corporation a Notice of Audit Assessment. The notice set forth that for the audit period of January 1, 1981,

through July 30, 1984, the total balance claimed by the Department as sales taxes due was $162,981.16.

H & H Beverage pursued its administrative remedies as provided under Pennsylvania law with regard to the Notice of Audit Assessment and for a reassessment. Obtaining no result satisfactory to it, the corporation then appealed unsuccessfully to the Commonwealth's Board of Finance and Revenue. H & H currently has its appeal pending before the Pennsylvania Commonwealth Court.

On January 16, 1986, H & H filed a complaint with the bankruptcy court and argued, inter alia, that the Commonwealth's auditing its records after its bankruptcy petition had been filed and issuing the Notice were acts in violation of the automatic stay

provisions of the Bankruptcy Code. The Commonwealth responded that it was entitled to calculate its claim for the purpose of filing a proof of claim with the bankruptcy court and that its notice was excepted from the automatic stay provisions by 11 U.S.C. 362(b)(9).

The bankruptcy court agreed with H & H on both its claims and the Commonwealth timely appealed to the district court. The District Court held that, although the act of auditing alone did not violate the automatic stay provisions, the act of auditing and issuing the "Notice of Audit Assessment" constituted an act to collect the taxes in violation of the Bankruptcy Code. See H&H Beverage Distributors, Inc. v. Department of Revenue of Pennsylvania, 79 Bankr. 205 (E.D. Pa. 1987). Upon appeal, the Court of Appeals reversed,

holding that the act of auditing per se by a taxing authority for the purpose of ascertaining its tax claim does not violate the automatic stay and that the issuance of the notice was protected by 11 U.S.C. 362(b)(9). H & H's petition to the Court of Appeals for rehearing was denied. See H&H Beverage Distributors, Inc. v. Department of Revenue of Pennsylvania, 850 F.2d 165 (3d Cir. 1988).

ARGUMENT

1. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT WITH DECISIONS OF THIS COURT AND OTHER FEDERAL COURTS THAT A STATE TAXING AUTHORITY IS ENTITLED TO AUDIT THE TAX RECORDS OF A DEBTOR IN BANKRUPTCY TO ASCERTAIN THE EXTENT OF ANY TAX CLAIMS IT MAY HAVE.

The Court of Appeals has held that the conducting of a sales tax audit by the Commonwealth of Pennsylvania of the tax records of H & H Beverage, Inc., a debtor-in-possession in a Chapter 11 bankruptcy proceeding, did not violate the automatic stay provisions of Section 362 of the Code, 11 U.S.C. 362. The Court held that the Commonwealth was entitled to audit H & H to ascertain the extent of any claim it may have. H & H Beverage Distributors, Inc. v. Department of Revenue of Pennsylvania, 850 F.2d 165, (3d Cir. 1988). In its

petition for a writ of certiorari, H & H asserts that the holding on the right to audit conflicts with three principles enunciated by this Court:

1. that a state's power to assess and collect state taxes must submit to the federal laws controlling the administration of the bankruptcy estate;
2. that only the bankruptcy court has jurisdiction to hear claims against the bankrupt; and
3. that tax collecting agencies are fully subject to the Bankruptcy Code in their collection efforts.

We will address each of these assertions.

1. The Commonwealth does not dispute federal supremacy in the administration of the bankruptcy estate. In fact, the Commonwealth based

its act of auditing not only on its state revenue statutes but upon the United States Bankruptcy Code. H & H, as a debtor-in-possession, had all of the duties of a Chapter 11 trustee. Those duties included providing books and records for inspection as required by a government unit. See 11 U.S.C. 1106, 1107. See Nicholas v. U.S., 384 U.S. 678 (1966).

The Court of Appeals below stated that auditing a debtor's sales tax records does not by itself constitute an act to create a lien or collect a claim. Every creditor, including taxing authorities, has a right to determine if it has a claim against the debtor. See In re Remington Rand, 836 F.2d 827 (3d Cir. 1988). Prohibiting a tax audit would prohibit the taxing authority from filing a proof of claim in the

bankruptcy proceeding. The Court cited congressional comments and Bankruptcy Rule 3001 as evidence of congressional intent that taxing authorities are permitted to file claims against the bankruptcy estate. See 124 Cong. Rec. H 11110 (daily ed. Sept. 28, 1978) and H&H Beverage Distributors, 850 F.2d 165, 167 (3d Cir. 1988). The Court of Appeals concluded that to prevent governmental units from determining whether a tax deficiency existed would render meaningless Section 362(b)(9), which expressly permits taxing entities to issue notices of deficiencies.

H & H cites Gardner v. New Jersey, 329 U.S. 565, (1947), among other cases, for the principle of federal law supremacy in administration of the bankruptcy estate. Gardner involved litigation between the state of New

Jersey and a bankruptcy trustee over the validity and extent of a proof of claim filed by New Jersey with the bankruptcy court for taxes claimed due. New Jersey challenged the bankruptcy court's jurisdiction to adjudicate the issues raised. The Court upheld the bankruptcy court's power to adjudicate the issues arising from the proof of claim filed.

A fair reading of Gardner shows that it enhances the right of a public agency to participate as a creditor in a bankruptcy reorganization by filing a proof of claim. This includes filing a proof of claim and having that claim's allowance adjudicated by the bankruptcy court. See 11 U.S.C. 501 and 502. H & H fails to show any conflict between Gardner and the instant case.

H & H cites New York v. Irving Trust

Company, 288 U. S. 329, (1933) and Van Huffel v. Harkelrode, 284 U.S. 225, (1931) for the same supremacy principle. The Irwing Trust case sustained an order of the bankruptcy court that barred a state's tax claim because it was not filed with the court within the time fixed for such filing. The Van Huffel case upheld thepower of the bankruptcy court to order estate property sold free and clear of local tax liens. Neither of these cases shows a conflict with the decision of the Court of Appeals in the instant case.

2. Secondly, H & H asserts that only the bankruptcy court has jurisdiction to hear claims against the bankrupt. H & H's petition fails to show any conflict between this assertion and the decision of the Court of Appeals. H & H cites in its petition

Kalb v. Feuerstein, 308 U.S. 433, (1940) in support of the exclusive jurisdiction of the bankruptcy court to hear claims against the bankrupt. The Commonwealth has not challenged the jurisdiction of the bankruptcy court to hear claims against the bankruptcy estate. After ascertaining its tax claim by audit, the Commonwealth sent notice of the amounts established by audit to H & H and then duly filed its proof of claim with the bankruptcy court. It was H & H, as the debtor-in-possession, who chose to contest the audit and to seek administrative remedies in the state forums provided. Having failed in such an endeavor, H & H then filed its complaint before the bankruptcy court.

3. Lastly, H & H compares the instant case to In re Nashville White

Truckers, Inc., 731 F.2d. 376 (6th Cir. 1984) and implies a conflict between the Courts of Appeal. Nashville White shows that the Commissioner of Revenue for the state of Tennessee was asserting, inter alia, a right to levy on property of the bankrupt estate to satisfy a state tax debt incurred by the debtor-in-possession and to exercise this right without first pursuing relief from the automatic stay through the bankruptcy court. The Court of Appeals affirmed the District Court in holding that such direct action was not permitted by law. The ascertainment of the amount due on a claim is not the same act as an act to levy or confiscate property to resolve a debt. The Nashville case does not conflict with the instant case.

The Commonwealth submits that H & H

has failed to produce any decisions of this Court or of any other federal court that conflicts with the decision of the Court of Appeals below that a state taxing authority is entitled to audit the tax records of a debtor in bankruptcy to ascertain the extent of any tax claim it may have. The petition for a writ of certiorari should be denied.

2. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT WITH DECISIONS OF THIS COURT AND OTHER FEDERAL COURTS THAT WHEN A STATE TAXING AUTHORITY'S ISSUANCE OF A "NOTICE OF AUDIT ASSESSMENT" IS THE FUNCTIONAL EQUIVALENT OF AN ISSUANCE OF A "NOTICE OF TAX DEFICIENCY" - AS THAT TERM IS USED IN THE BANKRUPTCY CODE, THE NOTICE IS, THEREFORE, AN ACT EXCEPTED FROM THE AUTOMATIC STAY PROVISIONS OF THE CODE BY 11 U.S.C. 362(b((9).

Section 362(a) (4) (5) (6), of the United States Bankruptcy Code 11 U.S.C. 362(a) (4), (5), (6), prohibits:

> ...(4) any act to create, perfect, or enforce any lien against property of the estate;
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
>
> (6) any act to collect, or to recover a claim against the debtor that arose before the commencement of the case under this title. (Emphasis added.)

Section 362(b)(9) reads in pertinent

part:

> The filing of a petition...., does not operate as a stay--...)
> (9) under subsection (a) of this section, the issuance to the debtor by a governmental unit of a notice of tax deficiency;.... (Emphasis added.)

Section 101(26) defines the term "governmental unit" to include a state or an instrumentality of a state. Therefore, Section 362(b)(9) is an exception to the automatic stay provision of Section 362(a) that applies to a state taxing authority. The Court below analyzed the statutory language and the legislative history and concluded that the Bankruptcy Code provides that all governmental taxing entities should receive equal treatment under Section 362. 850 F.2d at 168. Noting that the origin of Section 362(b)(9) was in the federal tax system,

the court examined and compared the federal Internal Revenue Service "Notice of Tax Deficiency" to the Pennsylvania "Notice of Audit Assessment." The Court concluded that the Commonwealth's notice was the functional equivalent of the notice of tax deficiency that is permitted under Section 362(b)(9). The Court found that there was no reason to permit the federal notice pursuant to 362(b)(9) and yet bar the equivalent state notice.

H & H bases its petition upon its assertion that the decision of the Court of Appeals will seriously hinder efficient administration of cases under the Bankrupty Code and that the methodology of statutory construction used by the court below conflicts with decisions of this Court. The Commonwealth submits that neither the

act of auditing nor the act of issuing its notice of audit assessment hinders the efficient administration of the Bankruptcy Code.

In essence, H & H argues that a taxing authority should have to petition the bankruptcy court for relief from the automatic stay prior to doing a tax audit. There is no provision in the Code that requires a creditor to seek such relief prior to calculating its claim in preparation for filing a proof of claim. If such a procedure were established, the bankruptcy court would be deluged with such petitions not only from taxing authorities, but from all other creditors.

H & H cites In re Stringer, 847 F.2d 549 (9th Cir. 1988), as an example of the proper statutory construction the Court in this instant case should have

used. In Stringer, the Court of Appeals held that the modification by a state court of a child support order after the filing of the bankruptcy petition was violative of the automatic stay provision and was not excepted by Section 362(b)(2). The Court held that the exception applied only to proceedings to collect child support that had been awarded by a court order entered prior to the filing of the bankruptcy petition. In so doing, the court noted that exceptions to the stay should be read narrowly to secure the broad grant of relief to the debtor. Stringer, supra. at 552.

Stringer does not conflict with the decision in the present case. The Stringer court and the court in the instant case both sought congressional intent by examining the involved

statutes, legislative history and prior case law. In Stringer, the court discerned that it was not the intent of Congress to include in the exemption of collection of child support the further concepts of modification, new suits, or similar actions. In the present case, the Court is not expanding the involved exception. It is clear that 362(b((9) applies to all governmental units, state and federal. It is also clear that "Notice of Tax Deficiency" as a term is of federal origin and that not all government units use such a term in their tax notices. Having found the notices of the state and of the IRS to be functional equivalents, it was not an expansion of the exception for the court to hold that such a state notice is also protected by Section 362(b)(9).

The Court of Appeals reached the

correct result and there is no reason to disturb the decision

CONCLUSION

For the above reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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